

**UNITED STATES BANKRUPTCY COURT  
DISTRICT OF NEW MEXICO**

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**Case Title:** LP Gas Equipment, Inc., et al. v. James Wayne Berry, et al.

**Case Number:** 03-01394

<b>Document Information</b>
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**Description:** Memorandum Opinion re: [9-1]First Amended Complaint .

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UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEW MEXICO

In re:

JAMES WAYNE BERRY,  
Debtor.

No. 7-03-16464 S

LP GAS EQUIPMENT, INC., et al.,  
Plaintiffs,  
v.

Adv. No. 03-1394 S

JAMES WAYNE BERRY, et al.,  
Defendants.

**MEMORANDUM OPINION**

This matter came before the Court for trial of Plaintiffs' First Amended Complaint ("Complaint") to Recover Money Damages and for Determination Excepting Debt from Discharge. Plaintiffs appeared through their attorney Eaton & Krehbiel, P.C. (P. Scott Eaton). James Berry ("Defendant") appeared through his attorney Michael Allison. Defendant abandoned his counterclaim at trial. This is a core proceeding<sup>1</sup>. 28 U.S.C. § 157(b)(2)(I).

The Complaint seeks a determination that Plaintiffs' debt is nondischargeable under 11 U.S.C. § 523(a)(2)(A),(4) and/or (6). Those sections provide:

(a) A discharge under section 727 ... of this title  
does not discharge an individual debtor from any debt--  
...

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<sup>1</sup>The Complaint also names Berry, Inc. and Berry, LLC as co-defendants. There is no bankruptcy jurisdiction over those entities, as the claims do not arise in or under the bankruptcy code, and whether those entities are liable to Plaintiffs is not related to the bankruptcy case. Therefore, the claims against those two defendants will be dismissed without prejudice. See Heagle v. Haug (In re Haug), 19 B.R. 223, 225 (Bankr. D. Or. 1982).

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

...  
[or]

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

...  
[or]

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity[.]

To succeed on a Section 523(a)(2)(A) claim, the creditor must prove 1) the debtor made a false representation, 2) the debtor made the representation with the intent to deceive the creditor, and 3) the creditor relied on the representation. Fowler Bros. v. Young (In re Young), 91 F.3d 1367, 1373 (10<sup>th</sup> Cir. 1996). The creditor's reliance must have been justifiable. Field v. Mans, 516 U.S. 59, 77 (1995). Finally, the debtor's representation must have caused the creditor to sustain the loss. Young, 91 F.3d at 1373. At trial, any doubts must be resolved in the debtor's favor. Chevy Chase Bank FSB v. Kukuk (In re Kukuk), 225 B.R. 778, 782 (10<sup>th</sup> Cir. BAP 1998).

To succeed on a Section 523(a)(4) claim, the creditor must prove one of three things: (1) fraud or defalcation while acting as a fiduciary; (2) embezzlement; or (3) larceny. No fiduciary relationship is necessary for embezzlement or larceny. Great American Ins. Co. v. Graziano (In re Graziano), 35 B.R. 589, 593-94 (Bankr. E.D. N.Y. 1983).

To succeed on a Section 523(a)(4) fiduciary duty claim, the creditor must prove (1) the existence of a fiduciary relationship between the debtor and the objecting creditor, and (2) a defalcation committed by the debtor in the course of that relationship. Antlers Roof-Truss & Builders Supply v. Storie (In re Storie), 216 B.R. 283, 286 (10<sup>th</sup> Cir. BAP 1997).

To succeed on a Section 523(a)(4) embezzlement claim a creditor must prove (1) entrustment to the debtor, of (2) property, (3) of another, (4) which the debtor appropriates for his or her own use, (5) with intent to defraud. Adamo v. Scheller (In re Scheller), 265 B.R. 39, 53 (Bankr. S.D. N.Y. 2001). See also Driqgs v. Black (In re Black), 787 F.2d 503, 507 (10<sup>th</sup> Cir. 1986):

"Embezzlement, for purposes of 11 U.S.C. § 523 'is the fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come, and it requires fraud in fact, involving moral turpitude or intentional wrong, rather than implied or constructive fraud.' " United States Life Title Insurance Co. v. Dohm (In re Dohm), 19 B.R. 134, 138 (Bankr. N.D. Ill.1982) (quoting American Family Insurance Group v. Gumieny (In re Gumieny), 8 B.R. 602, 605 (Bankr. E.D. Wis.1981)).

Embezzlement requires that the original receipt or taking of the property be legal. Scheller, 265 B.R. at 54. The property taken must also be another's, because one cannot embezzle one's own property. Id.

To succeed on a Section 523(a)(4) larceny claim a creditor must prove (1) the wrongful taking, of (2) property, (3) of

another, (4) without the owner's consent, and (5) with the intent to convert the property. Id. at 53. See also United States v. Smith, 156 F.3d 1046, 1056 (10<sup>th</sup> Cir. 1998), cert. denied, 525 U.S. 1090 (1999)(citing Black's Law Dictionary 1477 (6<sup>th</sup> ed. 1990) defining "larceny" as the "[f]elonious stealing, taking and carrying, leading, riding, or driving away with another's personal property, with intent to convert it or to deprive owner thereof.") Larceny requires that the original taking of the property be unlawful<sup>2</sup>. Scheller, 265 B.R. at 54. The property taken must also be another's, because one cannot convert one's own property. Id.

To succeed on a Section 523(a)(6) claim a creditor must prove a deliberate or intentional injury by the debtor to the creditor or the creditor's property. Kawaauhau v. Geiger, 523 U.S. 57, 61 (1998). Proof of a deliberate or intentional act that leads to injury is not sufficient. Id. Conversion, to be nondischargeable, must be willful and malicious; mere technical conversion is dischargeable. C.I.T. Financial Services v. Posta (In re Posta), 866 F.2d 364, 368 (10<sup>th</sup> Cir. 1989).

#### **FINDINGS OF FACT**

These findings of fact are based on the testimony elicited in a 5 day bench trial conducted by two excellent lawyers that

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<sup>2</sup> Larceny differs from embezzlement only with respect to the manner in which the property comes into possession of the wrongdoer. Scheller, 265 B.R. at 54.

were extremely prepared and organized, supplemented by a lengthy deposition of Defendant, and thousands of pages of documentary evidence. The Court observed the demeanor of the witnesses and resolved many conflicting versions of what transpired. Overall, the Court found the witnesses to be credible, with the exception of Defendant, who uniformly said what he believed would minimize his damages. The Court gave the most weight to the testimony of Sarah Franklin and Richard Joliett, and gave the least weight to the testimony of Defendant.

Plaintiff LP Gas Equipment, Inc. ("LP") is a corporation owned 100% by co-plaintiffs Sarah Franklin and Tom Franklin. Defendant is the nephew of Sarah and Tom Franklin. The Franklins organized LP and began operating in 1986 as a hardware store for the LP Gas Industry. The Franklins personally owned the real estate on which LP operated. Due to hard work and conservative business practices, LP was profitable and paid the Franklins an average of \$70,000 to \$100,000 per year over the next ten years.

On February 5, 2002 the Plaintiffs filed suit against Defendant and his two wholly owned companies in state court alleging the same facts as alleged in this Complaint. After one and one-half years of litigation, Defendant Wayne Berry filed a voluntary chapter 7 proceeding in this Court. This adversary proceeding was timely filed.

Other than the Franklins, Defendant was LP's first employee. Defendant worked for over 10 years in sales. In 1996 Defendant entered a contract to purchase Cartwrights Plumbing ("Cartwrights") in Santa Fe, New Mexico. Defendant borrowed \$30,000 from the Franklins to capitalize his new business. Defendant formed Berry, Inc. ("BI") to operate Cartwrights. Defendant also acquired the land on which Cartwrights operated through Berry, LLC ("LLC"). Defendant left LP and operated Cartwrights full time.

In September, 1996, Tom Franklin had a serious vehicle accident and suffered a traumatic brain injury. He never returned to work, is still in a wheelchair and has difficulties with the normal activities of daily living. While Tom was in rehabilitation, Defendant called Sarah and asked for a first option to buy LP, having heard that Sarah had received inquiries to purchase the business. Sarah agreed.

From 1996 to 1999 Sarah took over, to some extent, the operation of LP, assisted by her son Roger, Defendant's brother Russell and other employees. Sarah's background was not in the LP gas field, and she had a difficult time. Despite declining sales during this time, LP still had a profit because Sarah cut expenses, including lease payments to herself and Tom.

In early 1997 a lawsuit was filed against LP and others seeking over \$1 million damages that resulted from a failed

valve. LP's insurance carrier declined coverage. The lawsuit took Sarah's time and focus from the business for the next several years. During this time Russell was in "over his head" and also dealing with personal problems.

In 1999 LP had outgrown its building and decided to build a new headquarters on other land owned by the Franklins. Tom and Sarah personally contracted with Luther Construction to build the building. Construction commenced in October, 1999. LP moved into its 1/3rd of the space on March 15, 2000; LP intended to rent the remainder of the space.

BI sold its interest in Cartwrights in the fall of 1999.

BI was a subcontractor to Luther Construction on LP's new building. Sarah and Defendant had various conversations during the construction period about Defendant returning to LP. One conversation dealt with Defendant acquiring the stock of LP. He made an offer to Sarah of \$350,000 for 100% of the stock. She testified that she would not accept the \$350,000 because she wanted to have LP valued first. She had also had over ten other contacts about the business, and needed to conduct further research. She never agreed to accept the \$350,000 and does not believe that Defendant had any reason to believe that she had accepted. All parties agreed that, with the \$1 million lawsuit pending, this was not a good time to worry about transferring the stock.



LP's December, 1999 end of year balance sheet showed current assets of \$233,000 and total assets of \$262,000. Current liabilities were \$102,000 (\$36,000 line of credit, \$63,000 accounts payable, and \$3,000 of taxes); long term liabilities were \$55,000 on a note to shareholders; and stockholder equity was about \$104,000. Total income for 1999 was \$896,000. Net income was \$31,000. In early 2000 LP owed \$29,000 on the \$100,000 line of credit and had no other debts except current payments to vendors.

In early 2000 Sarah and Defendant had more conversations about his returning to LP. After the years of declining sales, there was a consensus that the operations had to be turned around, mostly through an increase in sales. Sarah testified that Defendant understood it would be a full time position. Defendant wanted a salary of \$70,000. Sarah negotiated a salary of \$48,000 plus use of the company's truck.

On or about March 1, 2000, Defendant returned to LP to serve as president. Sarah testified that it was mutually understood that Defendant would devote his undivided attention to LP. He was put in charge of all day to day activities of LP. The Franklins told the employees that Defendant and his brother were buying the assets of LP. The purpose behind these moves was to give Defendant and Russell authority, and for Sarah to walk away. Over the coming months Defendant hired some new employees and

took steps to modernize LP's operations through automation, new telephone systems, internal accounting, and various other means. Rich Joliett was hired as comptroller in October, 2000. Sarah testified that there were no discussions or understandings about Defendant entering contracts with himself or his entities for any purposes.

In August, 2000 the \$1 million dollar lawsuit settled, with no liability against LP. The Franklins had meanwhile been discussing various methods of transferring the stock to Defendant and Russell. One method involved gifting 51% of the stock to Defendant, with an accompanying restrictive operating agreement and a 2% of sales royalty to the Franklins. Under this method the Franklin's children were also to become partial owners; Defendant objected to this. Defendant also did not want to pay a royalty unless LP had a profit. None of the various methods ever proceeded to completion, however, and the Franklins remain 100% owners. Basically, the Court finds all of the various testimony regarding changing business forms and capitalization structures was irrelevant to the dischargeability issue; Defendant knew that he never held a single share of stock in LP.

Over the next year, Defendant and, to some extent the Franklins, sought out possible businesses to acquire to expand sales, inventory, and cash flow. None of the potential

acquisitions worked out. The Court finds that these actions are irrelevant to this case also.

In September, 2000 LP had cash flow problems and the Franklins loaned \$100,000 to LP. Sarah testified that she was not surprised because of the workforce expansion and modernization of the office.

LP's December, 2000 end of year balance sheet<sup>3</sup> showed current assets of \$445,000 and total assets of \$525,000. Current liabilities were \$345,000 (\$65,000 line of credit, \$272,000 accounts payable, and \$8,000 of taxes); long term liabilities were \$58,000 on a note to shareholders; and stockholder equity was about \$122,000. Total income for 1999 was \$1,401,000. Net income was \$22,000.

Despite modernizing the accounting system, it turned out that Defendant kept a separate LP check book, with a separate numbering system, locked in his office. Many checks were written from this checkbook, without the documentation that was required for normal checks issued through the accounting system. For months there had been an ongoing discussion between Defendant and the comptroller and Russell regarding these checks; because of

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<sup>3</sup>In late 2001, Plaintiffs discovered material omissions and misstatements in this balance sheet and income statement. E.g., the line of credit was understated by \$100,000, approximately \$74,000 of payables were omitted, and draws on the line of credit had been booked as revenues. A correct accounting would have shown a significant operating loss for the year.

them it had been impossible to determine accurate bank balances and many checks had been returned for insufficient funds. During this time period LP also suffered delinquent tax penalties, NSF charges, and bank service fees. The situation became so bad that Richard Joliett had to call the bank on a daily basis to determine how much he could write in checks because he never knew how many or how much was outstanding from Defendant's LP checkbook.

One job LP had during Defendant's tenure was the Kirtland Air Base "Crash fire" project, which was a fire-fighting training school. LP had done similar previous schools and both sold the necessary equipment and provided the designs for the systems. Defendant did not tell Sarah that BI would be involved in the Crash fire project, and according to Sarah's testimony there was no need for BI to be involved. Mr. Bruce Sivers, the contractor on the Crash fire project assumed he was dealing with LP, never thought or assumed he was dealing with BI, and never received an invoice from BI. Yet, Defendant charged LP, and paid himself, management fees for the Crash fire project. There were also no written contracts between BI and LP for this or any other job. Sarah had no idea that any money was going to Defendant, BI, LLC, or anyone else outside of Defendant's regular paychecks. Sivers also testified that he purchased all materials and supplies directly from LP and, when necessary, used LP employees for

labor. When shown several of BI's invoices to LP for various tasks on the Crash fire project, Mr. Siverson had no idea why BI would be charging LP For work done by him or his company.

In the spring of 2001 LP located a tenant ("ACS") for the rest of the new building. The Plaintiffs entered a contract with ACS for the build-out of the space. LP agreed to do the build-out at cost, because the tenant improvements were going to improve the value of the building. ACS agreed to pay \$70,000 to LP, who would pay for the material and supplies and provide the labor for the build-out. LP did provide the materials, supplies and labor but never received a check from ACS. Patrick Padilla, representative of ACS, testified that actually \$78,031.51 was paid to BI between March 29, 2001 and November 22, 2001, which included two months of rent in the total amount of \$14,156. The Court is not including this \$78,031.51 in damages, however, because it appears that the misdirected payments went to BI, not Defendant.

During the summer of 2001 Sarah Franklin heard rumors that LP was on the verge of bankruptcy, and then discovered through the outside CPA firm that LP had invoices up to six months old to be paid. Russell then told her not to pursue the stock transfer deals any further. She became suspicious. As a result, she asked the comptroller for a financial statement and copies of checks, and discovered that, indeed, the company was in bad

shape. LP owed \$265,000 to vendors, the payables were in the 90-120 day range, and LP owed \$200,000 on lines of credit<sup>4</sup>. Sarah, who had paid LP's bills for years, also recognized that many of the checks were to unidentified/unrecognized payees. LP was on COD with every vendor. Sarah set up a meeting with Defendant, Russell, the comptroller, and other employees to discuss the situation. She demanded to know where the money was going, who is it was going to, and what it was going for. The meeting was short, and ended with Defendant leaving, but promising to document every transaction. He claimed that some documentation was in his office, but that most was at home. Despite promising several times to provide documents, he never did. Defendant never returned to the office except once, at an unknown time, to remove all of his file cabinets and personal papers. Some documentation was provided to Plaintiffs several days before the start of this trial, consisting of invoices from BI to LP that were not found in LP's records. Richard Joliett (the comptroller) testified that despite repeated requests for invoices and other documentation on checks and credit card transfers, Defendant never provided any and he never discovered any anywhere in the records at LP. Due to the timing and due to

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<sup>4</sup>There had previously been only one \$100,000 line of credit. It was unclear from the testimony how the second \$100,000 line of credit was opened. Defendant attributed it to a bank error. Sarah only discovered its existence after Defendant left LP.

Defendant's failure to produce these documents in the state court case, the Court tends to believe and finds that these invoices were fabricated at the last minute to serve as trial exhibits.

In the months following the meeting, Sarah, Russell, the comptroller, and the outside CPAs conducted an extensive analysis of the financial condition of LP including looking at every invoice in the files and every purchase order to ensure that every legitimate transaction was properly documented and accounted for. They identified 131 undocumented checks. Their investigation also indicated that most, if not all, of these 131 checks were payable to Defendant or one of his entities, or on behalf of Defendant or one of his entities. Both Sarah Franklin and Defendant testified at trial about each of the 131 checks. Appendix A<sup>5</sup> lists these checks and contains the Court's comments on the evidence. The Court finds that Defendant made unauthorized withdrawals by check in the amount of \$215,946.97. Many of the checks were not coded properly in the checkbook. For example, a check for BI storage shed rental was coded as telephone expense; payments on Defendant's personal vehicle loan were recorded as equipment rental; insurance expense for LLC was coded as inventory. The checks, with a few exceptions, were not recorded as loans or amounts payable by Defendant or his

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<sup>5</sup>Appendix A should be considered to be additional findings of fact.

entities. Due to the volume of transactions, the amounts of the transactions, the missing and inadequate documentation, the omission of payees on the check stubs, and the miscoding of the account codes on the check stubs the Court finds that Defendant was attempting to conceal the transactions and intending to defraud LP. This fact is reinforced by Defendant's use of a checkbook outside of the accounting system, and his reluctance to follow established procedures to obtain funds.

There were also direct transfers out of LP's accounts to pay Defendant's personal credit cards; Exhibit 20 shows that \$34,925.07 was used to pay Defendant's personal credit cards, and the Court so finds. The Court also finds that the documentation Defendant supplied to justify these transfers was little more than a running balance and insufficient to justify any of the reimbursements/payments as legitimate business expenses. The Court also finds that Defendant was not authorized to make these payments.

Exhibit 21 consists of invoices given to Defendant to pass through invoices paid by LP for items properly payable by Defendant or his entities, that he caused to be paid through LP's accounting system. Exhibit 21 shows that \$55,037.59 was improperly paid by LP and billed to Defendant, and the Court so finds.



In addition, Exhibits 25(a)-(j) consist of items paid by LP for Defendant or his entities discovered or paid for after he left, so consequently had not been invoiced to him. These include:

Exhibit	Payee	Amount	Comment
25a			duplicate of check 19230
25b	Desa	243.95	
25c	Ferguson	580.48	
25d	Home Depot	2316.90	
25e	Kubota	1677.60	Tractor payments in addition to down payment
25f			fax in Defendant's home, court finds reasonable.
25g	Rental Service Center	1116.78	
25h	Sherwin Williams	160.27	
25i	Unico	6203.80	See Ex. 25i page 8 for amount.
25j	Viessman Mfg. Co.	5974.47	
25k		_____.	duplicate of check 19577
Total other charges		13455.32	

Exhibit 22 documents amounts paid back to LP by Defendant or his entities. The Court finds that \$90,319.48 was paid back.

Therefore, in summary, the Court calculates damages as follows:

Item	Amount
Unauthorized checks	\$ 215946.97
Transfers to credit cards	34925.07
Unpaid pass through invoices	55037.59
Other charges	<u>13455.32</u>
Subtotal	319364.95
Less: Reimbursements	<u>-90319.48</u>
Total <sup>6</sup>	\$ 229045.47

In the months that followed Defendant's exodus from LP, the Franklins decided to save the company and injected \$388,000 into it to pay vendors and restock the inventory.

#### **ADDITIONAL FINDINGS**

Defendant admitted that he was shifting money between LP, BI, and LLC as needed because he viewed all three businesses as one. Furthermore, he treated LP as if he owned it 100%, and in fact told Richard Joliett that he owned it and the land on which it was located.

LP was a vulnerable target for Defendant. Its former management was incapacitated, it was on a downward cycle and it needed clear direction to turn itself around. It had unsophisticated internal controls before Defendant's arrival, and then despite the controls initiated by Defendant, he was able to

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<sup>6</sup>This number substantially agrees with the expert's report, in which he opined that there was a loss of \$237,000 from Defendant's misappropriations.

circumvent them by keeping control of the checkbook and providing either little information or misleading information to the comptroller and the outside accountants. Furthermore, LP was a family business, and the family placed their trust in Defendant to operate the business in a proper, business-like way.

The methods used by Defendant were not an appropriate way to run a business, especially on behalf of someone else. Any reasonable person would have known that in the circumstances described above that he did not own LP, and that he had no right to treat his activities as other than as an employee. Certain expenditures were clearly inappropriate, for example: insurance for non-company vehicles, improvements on Defendant's house and property, improvements on the property in Santa Fe, the tractor, personal credit cards when no detailed accounting was provided simultaneously, furniture for Defendant's home, the stove and refrigerator for Defendant's mother. Other expenditures were inappropriate under the circumstances, for example: payment of management fees without a contract and without the knowledge of the stockholders of the company, charges for tenant improvements when the costs of those improvements and the labor for them were provided by LP. The expenditures that Defendant could not remember are absolutely inappropriate and shifted the burden to explain to Defendant, which he did not do.

Defendant's conduct was reprehensible and deserving of a punitive damage award.

On April 24, 2001, Wayne Berry answered interrogatories in his divorce case. Ex. 18. He listed gross income of \$4,000 per month and net income after payroll taxes of \$3,315 (page 21). He listed monthly expenses \$10,275 (page 24). He also listed few, if any, unencumbered assets. The Court finds that Defendant was supplementing his income through unauthorized transfers from Plaintiffs in order to sustain his life style.

The Court finds that Plaintiffs Sarah Franklin and Tom Franklin did not present sufficient evidence to find for them individually on any of the Counts of the complaint. While there was incidental evidence of loans by Sarah and Tom to Defendant, they did not establish that these loans were the result of fraud, misrepresentation, embezzlement, larceny, or willful and malicious injury. Furthermore, there was no testimony from them regarding reliance on any representations, or to the exact amount of damages. The Complaint will be dismissed as to Sarah and Tom Franklin with prejudice.

#### **CONCLUSIONS OF LAW**

The Complaint contains 14 causes of action, plus a section entitled "Damages" and one entitled "Nondischargeability". The latter two sections specify the amount of damages, and cite the legal theories under which the debt is nondischargeable, and

therefore do not constitute separate counts. The 14 causes of action are set out as follows.

1. Negligence.

Defendant moved to dismiss this cause of action for failure to state a claim. The Court agrees. Negligence does not result in a nondischargeable debt. Kawaauhau 523 U.S. at 64.

2. Negligent Misrepresentation.

Defendant also moved to dismiss this cause of action for failure to state a claim. The Court agrees. Negligent misrepresentation does not result in a nondischargeable debt. Buck v. Woodhull (In re Woodhull), 30 B.R. 83, 86 (Bankr. E.D. Ark. 1983).

3. Breach of Contract.

Defendant also moved to dismiss this cause of action for failure to state a claim. The Court agrees. A simple breach of contract is not nondischargeable; an intentional breach of contract is nondischargeable only when it is accompanied by malicious and willful tortious conduct. Petralia v. Jercich (In re Jercich), 238 F.3d 1202, 1205 (9<sup>th</sup> Cir.), cert. denied, 533 U.S. 930 (2001). Count 10 is for Willful and Malicious Injury, so this claim will be dealt with there.

4. Prima Facie Tort.

Defendant did not move to dismiss this count; the Court will do so on its own motion. Section 523 contains an exclusive list

of what debts are nondischargeable. Prima facie tort is not one. Unless the same conduct warrants a finding of nondischargeability under specific subsections of section 523, the debt would be discharged. Therefore, the Court will consider the elements of prima facie tort under other sections of the complaint.

5. Breach of Fiduciary Duty.

The existence of a fiduciary duty for section 523(a)(4) is a question of federal law, not a "fact" that can be pled. Van de Water v. Van de Water (In re Van de Water), 180 B.R. 283, 289 (Bankr. D. N.M. 1995)(Fiduciary capacity is a question of federal law; the general definition of fiduciary is too broad in the dischargeability context.); Fowler Bros. v. Young (In re Young), 91 F.3d 1367, 1371 (10th Cir. 1996) ("The existence of a fiduciary relationship under § 523(a)(4) is determined under federal law.") In Employers Workers' Compensation Assoc. v. Kelley (In re Kelley), 215 B.R. 468, 471-72 (10<sup>th</sup> Cir. BAP 1997), the Tenth Circuit Bankruptcy Appellate Panel discussed fiduciary duty:

Section 523(a)(4) of the Bankruptcy Code excepts from discharge any debt "for fraud or defalcation while acting in a fiduciary capacity." The Tenth Circuit recently explained the meaning of "fiduciary capacity" in this provision.

The existence of a fiduciary relationship under § 523(a)(4) is determined under federal law. However, state law is relevant to this inquiry. Under this circuit's federal bankruptcy case law, to find that a fiduciary relationship existed under § 523(a)(4), the court must find that the money or property on which the debt at issue was

based was entrusted to the debtor. Thus, an express or technical trust must be present for a fiduciary relationship to exist under § 523(a)(4). Neither a general fiduciary duty of confidence, trust, loyalty, and good faith, nor an inequality between the parties' knowledge or bargaining power, is sufficient to establish a fiduciary relationship for purposes of dischargeability. "Further, the fiduciary relationship must be shown to exist prior to the creation of the debt in controversy." [Allen v. Romero (In re Romero)], 535 F.2d [618,] 621 [(10th Cir. 1976)]. Fowler Bros. v. Young (In re Young), 91 F.3d 1367, 1371-72 (10th Cir. 1996)(additional citations omitted). We are, of course, obliged to apply this narrow view of the fiduciaries who are covered by § 523(a)(4).

The Court finds that there was no fiduciary duty owed in this case. First, there was no express or technical trust. Second, there was no duty owed before the creation of the debt in controversy. While there may have been common law fiduciary duties based on the family or business relationship, these do not qualify for Section 523(a)(4) purposes. Count 5 should be dismissed.

6. Fraud.

The Court finds that Plaintiffs have not established that they are entitled to a fraud judgment. While there may have been misrepresentations, the relief awarded under count 8 moots any claim for fraud damages.

7. Conversion.

The Court finds that this conversion claim is mooted by the relief granted under count 8, so will not discuss conversion.

8. Embezzlement.

The Court finds that Plaintiffs have met their burden of proof in showing that Defendant embezzled the sum of \$319,364.95 from LP. Defendant should be allowed an offset of \$90,319.48 for amounts returned, leaving a balance due of \$229,045.47.

9. Larceny.

Alternatively, the Court finds that Plaintiffs have met their burden of proof in showing that Defendant obtained \$229,045.47 through larceny.

10. Willful and Malicious Injury.

The Court finds that Plaintiffs did not meet their burden of proof in establishing that the injuries to LP were willful and malicious. While the degree of embezzlement/larceny indicates that it was certain to lead to injury, the Court cannot find that Defendant intentionally set out to damage LP. Therefore, there will be no award for the decrease in the value of the business that transpired while Defendant was president. Count 10 will be dismissed.

11. Restitution, Quantum Meruit and Unjust Enrichment.

Defendant also moved to dismiss this cause of action for failure to state a claim. The Court agrees. Section 523 contains an exclusive list of what debts are nondischargeable. Restitution, quantum meruit and unjust enrichment are not listed. Unless the same conduct warrants a finding of nondischargeability under specific subsections of section 523, the debt would be



discharged. Therefore, the Court will consider the elements of restitution, quantum meruit and unjust enrichment under other sections of the complaint.

12. Conversion.

The Court finds that this conversion claim is mooted by the relief granted under count 8, so will not discuss conversion.

13. Fraudulent Transfer.

Fraudulent transfers of assets from LP would result in a nondischargeable debt only if those transfers fit under sections 523(a)(2), (4), or (6). Count 13 will be dismissed.

14. Alter Ego/Veil Piercing.

Defendant also moved to dismiss this cause of action for failure to state a claim. The Court agrees. First, it is not an action under section 523 to hold a debt nondischargeable. Rather, this count seeks to disregard the corporate forms of Berry, Inc. and W.M. Berry, L.L.C. and declare that they should be held jointly and severally liable with Defendant on their debt. To the extent this count seeks to enhance assets of the estate, Plaintiffs lack standing.

Property of the estate does not belong to any individual creditor. If under governing state law the debtor could have asserted an alter ego claim to pierce its own corporate veil, that claim constitutes property of the bankrupt estate and can only be asserted by the trustee or the debtor-in-possession. As this Court stated:

Under the Bankruptcy Code, the bankruptcy trustee may bring claims founded ... on the rights of the debtor and on certain rights of the debtor's

creditors. Whether the rights belong to the debtor or the individual creditors is a question of state law ... If a claim is a general one, with no particularized injury arising from it, and if that claim could be brought by any creditor of the debtor, the trustee is the proper person to assert the claim, and the creditors are bound by the outcome of the trustee's action.

Kalb, Voorhis & Co. v. American Financial Corp., 8 F.3d 130, 132

(2<sup>nd</sup> Cir. 1993)(Footnote and citations omitted.) Only

Defendant's chapter 7 bankruptcy trustee may pursue this action.

See generally In re 7RCCI, Inc., No. 11-95-10590, slip op. at 7-8 (Bankr. D. N.M. Dec. 18, 1998).

Furthermore, the Court finds that Plaintiffs did not prove the required 3 elements to pierce the corporate veil: a showing of instrumentality or domination, improper purpose, and proximate causation. See Scott v. AZL Resources, Inc., 107 N.M. 118, 121, 753 P.2d 897, 900 (1988). Count 14 should be dismissed.

### **INTEREST**

Under New Mexico law, prejudgment interest is an element of damages. Foster v. Luce, 115 N.M. 331, 335, 850 P.2d 1034, 1038 (Ct.App. 1993). Plaintiff LP should receive prejudgment interest on its damages from February 5, 2002 at the rate of 10% per year. The judgment will reflect interest at the federal judgment rate from the date of entry.

### **PUNITIVE DAMAGES**

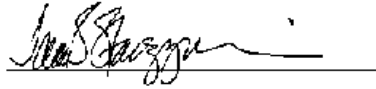
Reprehensibility is the most important guidepost for determining the reasonableness of a punitive damage award. [I]n assessing the reprehensibility of a

defendant's conduct, we ask whether the conduct: causes economic harm rather than physical harm; would be considered unlawful in all states; involves repeated acts rather than a single one; is intentional; involves deliberate false statements rather than omissions; and is aimed at a vulnerable target.

United Phosphorus, Ltd. v. Midland Fumigant, Inc., 205 F.3d 1219, 1229 (10<sup>th</sup> Cir. 2000)(Citations and internal punctuation omitted). While Defendant's conduct here caused economic harm, a mitigating factor, the rest of his conduct suggests that a large punitive damage award would be appropriate. Embezzlement and larceny are unlawful in all states. Defendant's actions included a series of hundreds of misdeeds. His actions were intentional and taken with disregard of the welfare of the victim. His actions included deliberate false statements, including falsifying financial statements to avoid detection, misrepresenting the ownership of LP, and even fabricating invoices at the last minute before trial. Finally, LP was a vulnerable target. Total damages awarded above were \$229,045.47. The Court finds that an award of an additional \$229,045.47 would be an appropriate punishment in these circumstances.

#### **CONCLUSION**

The complaint will be dismissed as to Berry, Inc. and Berry, LLC. Plaintiffs Tom and Sarah Franklin shall take nothing. Plaintiff LP shall be awarded judgment for damages, punitive damages, pre- and post-judgment interest, and said judgment will be nondischargeable in Defendant's chapter 7 bankruptcy case.



Honorable James S. Starzynski  
United States Bankruptcy Judge

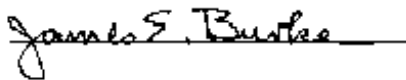
I hereby certify that on April 17, 2006, a true and correct copy of the foregoing was electronically transmitted, faxed, delivered, or mailed to the listed counsel and/or parties.

Thomas D Walker  
500 Marquette Ave NW Ste 650  
Albuquerque, NM 87102-5309

P Scott Eaton  
PO Box 25305  
Albuquerque, NM 87125-0305

Daniel J Behles  
226-A Cynthia Loop NW  
Albuquerque, NM 87114-1100

Michael Allison  
1400 Central Ave SE Ste 2200  
Albuquerque, NM 87106-4857



**APPENDIX A**

Key:

† = Defendant testified he was not sure what the expense was.

‡ = Court was satisfied that this was a legitimate expense.

Date	Number	Payee	Amount	Check Stub	Comments	Allowed
3/15/00	19015	Travelers	600.96	Inventory	liability insurance for BI	
3/15/00	19016	Zurich	128.94	Inventory	insurance for LLC's Santa Fe building	
3/21/00	19018	BI	850.00	Subcontract	†	
3/22/00	19036	BI	1800.00		†	
3/27/00	19038	Cash	300.00	Bonuses	‡ - employees worked Saturday to move	300.00
3/30/00	19044	Travelers	563.59		insurance for BI	
3/31/00	19051	Petty Cash	100.00		† - no receipts, no real explanation	
4/10/00	19061	Cash	100.00	Travel Exp.	‡ - travel to Denver re: acquisition	100.00
4/17/00	19078	Wayne Berry	2045.00	Equipment	‡ - sold old chassis to LP to make service chassis, was on premises when he left. Cf. Ex. Q.	2045.00
4/21/00	19084	Cash	177.50	Temp labor	‡ - work on new building	177.50
4/24/00	19088	Sisco	47.87	Inventory	‡ - sprinkler head, Luther did not finish landscaping	47.87
4/26/00	19124	Wayne Berry	750.00	Truck exp	Defendant testified for an air compressor, cf. Ex. S, but no air compressor on premises	
4/28/00	19135	Cash	500.00	Petty Cash	no documentation	

Date	Number	Payee	Amount	Check Stub	Comments	Allowed
5/09/00	19149	BI	442.94	Inventory	Ex. T says charging for the Crash Fire Project; depo testimony said for pipes purchased for LP job. Insufficient documentation.	
5/11/00	19150	Airtouch	883.03	Cell phone	Cell phone for BI; no breakdown for LP use. Insufficient documentation.	
5/11/00	19151	IHES	1276.75	Vehicle exp	† Check says Cartwright's expense.	
5/17/00	19166	Cash	150.00		†	
5/17/00	19167	BI	561.50	Subcontract	BI invoice. Insufficient documentation.	
5/24/00	19185	ATT Universal Card	839.64	Office exp	Wayne Berry's personal credit card. Insufficient documentation.	
5/25/00	19187	IHES	328.53	Vehicle exp	†. Check has same account reference as check 19151.	
5/25/00	19189	Storage USA	273.59	Telephone	BI's storage unit.	
5/26/00	19191	cash	156.32	Travel	†. No documentation.	
6/01/00	19200	Zurich	180.41	Insurance	LLC insurance.	
6/2/00	19201	cash	180.00	Temp labor	No documentation.	
6/5/00	19205	BI	1973.07	Subcontract	Defendant could not recall at deposition. At trial, produced Exhibit W. Insufficient documentation. Crash fire management fee.	
6/8/00	19214	BI	400.00	Subcontract	†. Exhibit X. Inventory resold by LP.	400.00

Date	Number	Payee	Amount	Check Stub	Comments	Allowed
6/15/00	19230	Cunningham	868.00	Inventory	†. Refrigerator and stove given to Defendant's mother.	
6/15/00	19243	Joelle Jones	40.00	Temp labor	Defendant could not recall at deposition. This check was to his babysitter.	
6/19/00	19251	cash	182.37	Travel	†. Insufficient documentation.	
6/19/00	19252	Wayne Berry	450.00	Travel	†. Travel to Colorado convention.	450.00
6/19/00	19253	Wayne Berry	2275.00	Equipment	Defendant could not recall at deposition. Defendant testified at trial this was for a tool trailer. None on premises when he left.	
7/7/00	19284	cash	600.00	U haul job	†. Money for U haul job in Phoenix. Ex DD.	600.00
7/12/00	19290	cash	600.00	Travel-u haul job	†. Phoenix job.	600.00
7/14/00	19303	cash	600.00	U haul job	†. Phoenix job.	600.00
7/14/00	19304	BI	2350.00		Defendant could not recall at deposition. Crash fire management fee - insufficient documentation.	
7/17/00	19314	cash	100.00	Russ convention	†. Russell's convention expenses.	100.00
7/18/00	19316	Citibank	1000.00	Travel exp.	Defendant's personal credit card.	
7/18/00	19317	Providian	590.00	Airline tickets school	Defendant's personal credit card.	

Date	Number	Payee	Amount	Check Stub	Comments	Allowed
7/18/00	19318	ATT Universal Card Universal Card	580.37	Travel exp.	Defendant's personal credit card.	
7/27/00	19334	Wayne Berry	500.00		†. Defendant billed LP and LP billed Colorado Tank, who paid.	500.00
7/27/00	19335	LLC	187.63		†	
8/10/00	19388	Bank of Santa Fe	1269.62	Equipment rental Uhaul	Defendant's truck payment. <u>See also</u> Ex. 18, p. 16 (listing truck payment as a work benefit in his divorce case.)	
8/15/00	19390	Storage USA	560.10	Container for fire training job	BI's storage unit.	
8/14/00	19392	Comdata Corp	773.06	Vehicle exp.	Defendant testified used Cartwright's gas credit card, but no breakdown. Insufficient documentation.	
8/15/00	19403	BI	1300.00	Subcontract	Crash fire management fee.	
8/16/00	19407	LLC	3800.00	Loan	unauthorized loan; repaid on general ledger, Exhibit SSSS page 3.	
8/16/00	19408	Wayne Berry	1046.82		†	
8/18/00	19409	cash	300.00	Travel Seattle	†. Travel to Seattle re: possible acquisition.	300.00
9/8/00	19455	Cash	152.16	Travel	†	
9/14/00	19464	Wayne Berry	518.00		†	



Date	Number	Payee	Amount	Check Stub	Comments	Allowed
9/20/00	19481	BI	2450.00	Subcontract	Defendant could not recall at deposition. At trial produced Exhibit HH, crash fire project invoice. Insufficient documentation.	
9/22/00	19508	Citibank	3750.00	Computer travel exp.	Defendant's personal credit card, used to purchase home computer.	
09/21/00	19515	Wayne Berry	2287.00	Subcontract	Exhibit KK, crash fire project, insufficient documentation.	
10/02/00	19529	TLC Plumbing	7506.98	Leasehold improvements	‡. Work on new LP building. (This charge probably should have been paid by Luther.)	7506.98
10/05/00	19539	ELC Security Products	463.66	Inventory	Security system for Defendant's house.	
10/06/00	19544	Brent Gossett	1200.00	Inventory	‡. Meter parts and equipment, put in inventory, resold by LP.	1200.00
10/10/00	19557	BI	1250.00	Subcontract	Management fee.	
10/10/00	19558	Discover	500.00	Travel	Defendant's personal credit card.	
10/10/00	19572	Bank of Santa Fe	1909.43	Vehicle expense	Defendant's truck payment.	
10/11/00	19577	Bank of America	20724.26		Defendant used this check to obtain a cashiers check to repay a personal loan to Sarah. See also Exhibit 25K.	
10/18/00	19591	BI	1830.00	Subcontract	Management fee.	

Date	Number	Payee	Amount	Check Stub	Comments	Allowed
10/18/00	19592	LLC	125.00	Reimbursement	Defendant did not recall at deposition. At trial he testified it was for a permit. Sarah testified they never had the permit.	
10/20/00	19612	Action RV	346.91		†. Trailer hitch for Defendant's trailer.	
11/08/00	19679	USAA Federal Savings Bank	1625.00	Office furniture.	‡. Office furniture for Defendant and Rich, charged on Defendant's personal credit card and reimbursed.	1625.00
11/10/00	19682	Citibank	1000.00	Travel	Defendant's personal credit card.	
11/10/00	19683	Discover	1000.00	Travel	Defendant's personal credit card.	
11/13/00	19686	BI	542.00	Subcontract	Management fee.	
11/17/00	19688	BI	3015.00	Subcontract	Management fee.	
11/21/00	20036	Barrow Services	3000.00		†. No documentation.	
11/28/00	19691	Cash	300.00	Petty cash	No documentation.	
11/30/00	19692	Wayne Berry	1000.00		Management fee. See Ex. YY page 2.	
12/01/00	19694	A-1 Signs	1483.06	Leasehold improvements	Sign for Cartwrights in Santa Fe.	
12/06/00	19695	Ernie Vigil Roofing	6812.00	Leasehold improvements	Roof on Defendant's property.	
12/06/00	19697	Doyle Roof Masters	300.00	Leasehold improvements	‡. Leak on LP's building.	300.00

Date	Number	Payee	Amount	Check Stub	Comments	Allowed
12/06/00	19698	Storage USA	407.19	Construction costs	BI's storage shed.	
12/09/00	19699	Metal Depot	206.91	Materials	Supplies for both LP & Defendant's house, no breakdown, insufficient documentation.	
12/08/00	19700	Ray Jahannsan	206.91	Subcontract labor	Labor at both LP & Defendant's house, no breakdown, insufficient documentation.	
12/08/00	19701	Jeff Barrows	2870.00	Subcontract labor	Construction at both LP & Defendant's house, no breakdown, insufficient documentation.	
12/11/00	19702	Costco	1965.86	Computer	Home computer for Defendant.	
12/13/00	19703	Wayne Berry	1500.00		†	
12/18/00	19704	BI	2627.00		†	
12/21/00	19706	Liens, Inc.	1513.03	Legal fees	Either all Cartwright's expense, or possibly some LP expense, but no breakdown, insufficient documentation.	
12/23/00	19707	Mesa Tractor	3125.00	Tractor	Down payment on Defendant's home tractor. <u>See</u> Ex. 18, p. 13 (divorce asset worksheet)	
12/29/00	19708	BI	884.00	Subcontract	†	
1/3/01	19709	Metal Depot	312.80	Inventory	†. Metal gates at LP.	312.80
1/3/01	19710	Barrow Services	798.00	Subcontract	Work on Defendant's house, probably fencing.	

Date	Number	Payee	Amount	Check Stub	Comments	Allowed
1/18/01	19712	Furniture Row	1296.30		Furniture for Defendant's home.	
1/18/01	19713	Bank of Santa Fe	1939.43	Vehicle expense	Defendant's truck payment.	
1/22/01	19714	BI	1840.00	Subcontract	‡. Exhibit TT - U haul job.	1840.00
2/01/01	19715	BI	2000.00	Subcontract	†	
2/10/01	19716	Storage USA	152.91	Construction	BI's storage unit.	
2/20/01	19717	BI	2641.00	Subcontract	Management fee.	
3/5/01	19719	BI	1017.00		‡. Tenant Improvements. Exhibit JJJ.	1017.00
3/7/01	19720	LLC	10000.00	Loan	Unauthorized loan for divorce attorney.	
3/15/01	19721	BI	2817.00	Subcontract	†	
3/15/01	19722	Wayne Berry	733.00	Reimbursement	†. No documents.	
3/16/01	19723	USAA Savings Bank	200.00	Office supplies	Defendant's personal credit card.	
3/20/01	19724	Academy Furniture	1541.06		Furniture for Defendant's house.	
3/21/01	19725	Wayne Berry	2500.00		†	
3/26/00	19727	BI	3780.00		†	
3/28/01	20508	AA Sanchez	1800.00		Work on both LP building and Defendant's house, but no breakdown given. Insufficient documentation.	

Date	Number	Payee	Amount	Check Stub	Comments	Allowed
4/6/01	19728	Cash	300.00		†	
4/6/01	19729	Frame N Art	1534.03		Defendant framed his Tae Kwan Do certificates.	
4/11/01	19730	Sam's Club	750.00		†. Groceries for Defendant.	
4/13/01	19731	LLC	14000.00	Loan	Unauthorized loan. \$10,000 was repaid from a subsequent \$11,000 loan by Sarah to Defendant. She is still owed the \$11,000, however.	
4/13/01	19732	cash	318.31	TI-labor	no documentation.	
4/20/01	19733	BI	3728.85	TI-wall	Sarah testified that no tenant improvements were ongoing at this time. Furthermore, when there were TI going on, LP paid for the materials and provided the labor with LP employees. BI would have no claim for TI.	
5/02/01	19734	BI	6325.00		no documentation.	
5/2/01	19735	Wayne Berry	2000.00	Reimbursement	†	
5/2/01	19736	Bank of Santa Fe	1959.43		Defendant's truck payments.	
5/3/01	19737	BI	4327.00	TI	No tenant improvements at this time. No documentation.	
5/10/01	19738	BI	3871.00	TI	No tenant improvements at this time. No documentation.	
5/22/01	19739	BI	2145.00	TI	No tenant improvements at this time. No documentation.	

Date	Number	Payee	Amount	Check Stub	Comments	Allowed
5/22/01	19740	BI	2010.00	TI	No tenant improvements at this time. No documentation.	
6/01/01	19742	cash	200.00	TI labor	No tenant improvements at this time. No documentation.	
6/7/01	20733	BI	1500.00		†	
6/19/01	19743	BI	5187.00	TI	No tenant improvements at this time. No documentation.	
7/8/01	19744	Costco	84.65	Membership	‡	84.65
7/10/01	19745	BI	5782.00	TI	No documentation.	
7/13/01	19746	cash	200.00	Temp. labor	No documentation.	
7/13/01	19747	Storage USA	274.73	Construction	BI's storage shed.	
7/17/01	19749	BI	1787.00	TI	No documentation.	
7/27/01	19750	Cash	300.00		†	
7/27/01	19751	BI	9539.19		Defendant thought TI, but no documentation.	
7/28/01	19752	Discover Card	500.00		Defendant's personal credit card.	
8/6/01	19753	BI	10848.29		No documentation.	
9/11/01	20976	Sams Club	915.77		†	
9/17/01	19756	LLC	3872.00		Unauthorized loan.	
10/05/01	19760	Storage USA	<u>447.05</u>		BI's storage shed.	<u>          </u>
Total claimed unauthorized checks			236053.77			Total authorized 20106.80

Date	Number	Payee	Amount	Check Stub	Comments	Allowed
Less: Authorized			<u>-20106.80</u>			
Total unauthorized checks			215946.97			